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C O N F I D E N T I A L SECTION 01 OF 03 BUENOS AIRES 001491

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SUBJECT: ARGENTINE CENTRAL BANK PRESIDENT CRITICIZES MANNER
IN WHICH GOA HANDLED PENSION NATIONALIZATION AND ADMITS
2009 GROWTH WILL BE DRAMATICALLY LOWER

REF: A. BUENOS AIRES 1475

[1](#)B. BUENOS AIRES 1466

[1](#)C. BUENOS AIRES 1458

[1](#)D. BUENOS AIRES 1443

[1](#)E. BUENOS AIRES 1442

[1](#)F. BUENOS AIRES 1415

Classified By: Ambassador E.A. Wayne for Reasons 1.4 (b,d)

Summary

[1](#)1. (C) In an exceptionally candid conversation, amid false rumors of his impending resignation, Central Bank (BCRA) President Martin Redrado confirmed to Ambassador October 24 that only four GoA officials made the decision to nationalize the private pension system, and commented that the decision was not transparent or well-conceived. While the GoA has since sought to mollify private concerns about the proposal, Redrado commented that "perception is reality" and the subsequent market crash demonstrated the private sector's thoughts about the measure. He agreed that the ensuing market reaction, capital outflows, and pressure on the peso worsened the prospect for quick Congressional passage of the measure. Contrary to some in the GoA who think currency devaluation is the answer to Argentina's economic problems, Redrado said it would just feed pressures for further depreciation, and stated that the Kirchners adamantly oppose a weaker peso. Nevertheless, the BCRA is struggling to keep the peso from further slipping in a rapidly deteriorating environment, and Redrado admitted that 2009 growth prospects will be in the range of 3%, well below previous estimates, and added that the outlook is heavily dependent on what movements in both the Brazilian Real and the price of soy. Redrado's comments on Argentina's preparations for November 15 G-20 meeting provided septel. End Summary.

Candid Assessment of GoA Mishandling of Pension Decision

[1](#)3. (C) In one of the most open and candid conversations we've had with him in the last two years, Argentine Central Bank President Martin Redrado provided the Ambassador extremely blunt commentary on the reaction to the GoA's October 21 announcement on the nationalization of the private pension funds (known as AFJPs), as well as on the BCRA's efforts to maintain a stable currency and diminishing growth prospects for 2009. The late afternoon meeting on October 27 took place as Argentine press were widely (and erroneously) reporting that Redrado had decided to resign in disgust over the AFJPs decision and the general direction of GoA economic

policy. Contrary to market rumors, Redrado did not come across as a man about to leave office; in fact, given the difficult circumstances of recent weeks (see reftels for details), he came across as extremely relaxed and confident. (Redrado has since several times publicly dismissed the resignation rumors as baseless.)

¶4. (C) Redrado confirmed that only four GoA officials made the decision to nationalize the AFJPs. (Comment: presumably, these four were CFK, former-President Nestor Kirchner, Legal Secretary Carlos Zannini, and Cabinet Chief Sergio Massa.) While stating that he did not want to give an opinion about the advisability of nationalizing the AFJPs, he bluntly noted that the key decision makers had clearly not thought through all the possible consequences.

¶5. (C) The GoA has since clarified its intentions (including asserting that it will not use AFJP equity holdings to manipulate local companies). Redrado stated that "the President has personally conveyed to me that there is no intention of using the nationalization to influence or control companies." However, he acknowledged that "perception is reality" and the subsequent market crash clearly demonstrates what the private sector has been thinking about the measure. He also agreed with the Ambassador's comment that the prospect for quick passage of the GoA bill has deteriorated following the negative fallout in local markets, with increasing concerns raised by the opposition and provinces that may cause delays, especially in the Senate.

¶6. (C) Redrado said he has tried to help clean up after the

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fact, meeting with foreign banks and AFJPs to assuage their concerns about GoA intentions and also explaining to the GoA that it needed to modify the one-week freeze on AFJPs' operations to allow basic portfolio maintenance (for example, rolling over fixed-term deposits coming due). However, he said, "the way it was handled was not very transparent, so there is a lot of work to do (to repair damage done)." (The Ambassador highlighted that there were U.S. company equities at play, including MetLife and New York Life, which raised the profile in Washington. Redrado said he knew MetLife was majority owner of Met AFJP, but commented that he was aware that New York Life was a minority shareholder in HSBC's AFJP, "Maxima.")

Concerns over Deteriorating Economy and Weakening Peso

¶7. (C) Redrado acknowledged as true rumors that the GoA had initially considered implementing sizable currency devaluation (instead of AFJP nationalization) as the best way to bolster GoA finances (through increased export tax revenues), improve the competitiveness of Argentine exporters, and protect domestic industry. (Comment: assuming devaluation led to higher inflation, it would also give the GoA a means to reduce expenditures in real terms.) However, Redrado stated, both Kirchners made it clear that they would not support a devaluation. (Comment: Banking sector contacts tell Post that, after Nestor Kirchner rejected devaluation as an option, GoA officials began to consider the AFJP nationalization. According to these sources, the Kirchners were worried that devaluation would result in higher inflation and higher wage demands, and the Kirchners want to avoid problems with labor unions prior to the October 2009 mid-term elections.)

¶8. (C) Redrado added that many in GoA do not understand that the Argentine mentality is to flee into dollars at the first sign of weakness in the peso. Therefore, he argued, affecting a roughly 10% devaluation to the range of 3.5 to 3.6 pesos/dollar (from the closing rate on October 24 of 3.29 pesos/dollar) would just increase public expectations of a

further devaluation to the range of 4 pesos/dollar.
(Comment: Despite Redrado's stated commitment to preventing significant devaluation, pressures on the peso continue, and the exchange rate hit 3.44 pesos/dollar in mid-market trading October 29. According to traders, the BCRA responded by intervening to sell a full \$1 billion in reserves, its largest sale of dollars this year, which succeeded in at least temporarily stabilizing the rate at 3.37.)

¶9. (C) In response to Econoff's question about private analysts' increasingly pessimistic predictions for real growth in 2009, Redrado commented that private estimates of a 1-2% real contraction next year are too negative. While acknowledging that the BCRA still had to review its previous assumptions, Redrado argued that the economy will expand 1.5-2% in real terms just as a result of statistical carryover, and his estimate for full-year real growth is in the range of 3%. (This is still well below BCRA estimates from earlier in the year) But Redrado admitted there was still great uncertainty about the next year.

¶10. (C) Redrado agreed that high inflation had played a key role in dampening growth through July of this year, but blamed turmoil in local markets since August on the psychological impact of the global crisis. In addition, Redrado noted that much of the outlook depends on what is temporary and what is permanent, and he justified his higher growth estimates on his assumption that both the fall in the price of soy and the weakened Brazilian Real are temporary phenomena. He highlighted the importance of soy prices on Argentine expectations: as soy prices fall, revenues fall, and estimates of default risks rise because concerns rise about the sustainability of the GoA's two foundational pillars -- the trade and fiscal surpluses. So, analysts have rapidly cut growth estimates as soy futures have plummeted from \$600/ton in July to \$350/ton in October. However, the BCRA's full-year 2009 estimates for soy prices are higher than the current futures price level, he said.

¶11. The situation in Brazil is also a critical variable for Argentine decision-makers. Redrado noted that the sharp depreciation in the Real over the last few months has caused major consternation among Argentine industrialists worried

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about being swamped with cheap Brazilian imports and among exporters worried about losing competitiveness in Brazil. Nevertheless, Redrado also saw this as temporary. He said that much of the Real depreciation was a result of the global flight to quality (out of emerging markets into Treasury bills). However, Brazil's Central Bank Governor recently told him that a significant part of the downward pressure on the Real was also temporary, resulting from the need for about 220 companies (including 30 banks) to buy dollars to cover approximately \$40 billion in futures contracts, in which they had bet on the Real to appreciate. Therefore, Redrado said he expects some pull-back, moderating the impact on Argentine industry and the export sectors.

WAYNE